



**BellSouth Telecommunications, Inc.**

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OCT 6 2000

EXECUTIVE SECRETARY

VIA HAND DELIVERY

David Waddell, Executive Secretary  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37238

Re: *All Telephone Companies Tariff Filings Regarding Reclassification Of  
Pay Telephone Service As Required By Federal Communications  
Commission (FCC) Docket 96-128  
Docket No. 97-00409*

Dear Mr. Waddell:

Enclosed are the original and thirteen copies of BellSouth's Rebuttal  
Testimony in this matter. Testimony is being provided by

Sandy E. Sanders  
D. Daonne Caldwell  
William E. Taylor.

Copies of the enclosed are being provided to counsel of record for all parties.

Very truly yours,

Guy M. Hicks

GMH:ch  
Enclosure

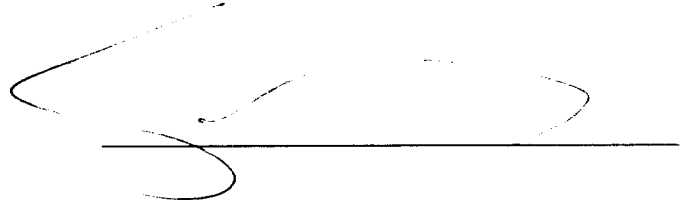
### CERTIFICATE OF SERVICE

I hereby certify that on October 6, 2000, a copy of the foregoing document was served on the parties of record, as follows:

<input type="checkbox"/> Hand	Cynthia Kinser, Esquire
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- ☐ Hand
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- ☐ Facsimile
- ☐ Overnight

Guilford Thornton, Esquire  
Stokes, Bartholomew, et al.  
424 Church St., #2800  
Nashville, TN 37219-2323

A handwritten signature in black ink, appearing to be "G. Thornton", written over a horizontal line.

**BELLSOUTH TELECOMMUNICATIONS, INC.**

**REBUTTAL TESTIMONY OF SANDY E. SANDERS**

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**DOCKET NO. 97-00409**

**OCTOBER 6, 2000**

**Q. PLEASE STATE YOUR NAME AND ADDRESS.**

A. My name is Sandy E. Sanders and my business address is 675 W. Peachtree Street, N.E., Atlanta, Georgia.

**Q. BY WHOM ARE YOU EMPLOYED?**

A. I am employed by BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth" or "the Company") as a Manager - Federal Regulatory.

**Q. ARE YOU THE SAME SANDY E. SANDERS WHO FILED DIRECT TESTIMONY ON SEPTEMBER 15, 2000?**

A. Yes.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

1 A. The purpose of my testimony is to respond to certain assertions made by the  
2 Tennessee Payphone Owners Association (TPOA) witness Mr. Don Wood.

3  
4 **Q. ON PAGES 5 AND 6 OF HIS DIRECT TESTIMONY, MR. WOOD DESCRIBES**  
5 **FOUR DISTINCT CRITERIA THAT HE BELIEVES AN INCUMBENT LOCAL**  
6 **EXCHANGE COMPANY'S ("ILEC'S") PAYPHONE ACCESS SERVICES**  
7 **RATES MUST MEET TO BE IN COMPLIANCE WITH THE FEDERAL**  
8 **COMMUNICATION COMMISSION'S ("FCC'S") PAYPHONE ORDERS. HE**  
9 **CONTENDS THAT A LEC'S RATES FOR PAYPHONE SERVICES MUST BE**  
10 **COST BASED, CONSISTENT WITH THE REQUIREMENTS OF SECTION 276**  
11 **OF THE TELECOMMUNICATIONS ACT OF 1996 ("THE ACT"),**  
12 **NONDISCRIMINATORY AND IN COMPLIANCE WITH THE FCC'S COMPUTER**  
13 **III TARIFFING GUIDELINES (I.E., IN COMPLIANCE WITH THE "NEW**  
14 **SERVICES" TEST). DO YOU AGREE WITH THIS?**

15  
16 A. Mr. Wood is correct that the FCC's Payphone Orders require that these four  
17 criteria be met for payphones services. However, as I pointed out in my direct  
18 testimony, BellSouth's position is that while these requirements appear to be  
19 separate issues, a tariff which complies with the "new services" test will  
20 necessarily satisfy the other requirements articulated by the FCC. (See Page 14  
21 of my direct testimony). Further, the very purpose of the "new services" test is to  
22 ensure that a rate is cost based, free of subsidies from other services and  
23 nondiscriminatory.

1  
2 **Q. ON PAGES 8 AND 9 OF HIS TESTIMONY, MR. WOOD CITES A COUPLE OF**  
3 **STATE COMMISSIONS WHICH FOUND THAT CERTAIN PAYPHONE RATES**  
4 **IN THEIR STATES DID NOT MEET THE “NEW SERVICES” TEST. HAVE**  
5 **OTHER STATE COMMISSIONS DETERMINED THAT INTRASTATE**  
6 **PAYPHONE SERVICES IN THEIR RESPECTIVE STATES HAVE IN FACT MET**  
7 **THE REQUIREMENTS OF THE “NEW SERVICES” TEST?**

8  
9 **A.** Yes. In BellSouth's serving regions, the Alabama Public Service Commission  
10 (“APSC”), the Florida Public Service Commission (“FPSC”) and the North  
11 Carolina Utilities Commission (“NCUC”) ruled that BellSouth's rates for intrastate  
12 payphone services met the requirements of the “new services” test. In Docket  
13 No.25982, the Alabama Commission ruled that BellSouth's “rates (for payphone  
14 services) are in compliance with federal guidelines, are just and reasonable and  
15 nondiscriminatory, and recover a reasonable portion of overhead costs; and that  
16 the proposed rates do not subsidize the pay phones of the Petitioner's sister  
17 company”. (See Page 2 of APSC Order dated October 3, 1997 in Docket No.  
18 25982).

19  
20 In Docket No. 970281-TL, the FPSC determined that the “LECs' current tariffed  
21 rates for intrastate payphone services are cost-based and thus meet the ‘new  
22 services’ test”. Further, the Commission ruled that “we find that the existing  
23 LEC tariffs for payphone services are cost-based, consistent with Section 276 of

1 the Act, and nondiscriminatory; therefore no further filings are necessary". (See  
2 Pages 4 and 6 FPSC Order No. PSC-98-1088-FOF-TL dated August 11, 1998 in  
3 Docket No. 970281-TL).

4  
5 The NCUC, in Docket No. 100, Sub 84b, ordered that "the Commission finds that  
6 local exchange companies' existing intrastate tariffs for payphone services are  
7 cost based, consistent with the requirements of Section 276 of the Act with  
8 regard to the removal of subsidies from exchange and exchange access  
9 services, are nondiscriminatory, and meet the new services test." (See Pages 13  
10 and 14 of NCUC Order in Docket No. P-100, Sub 84b dated June 16, 1999).

11  
12 **Q. MR. WOOD STATES ON PAGES 11 AND 12 OF HIS TESTIMONY "WHEN**  
13 **APPLYING THE FCC'S NEW SERVICES TEST, THE TERM 'OVERHEAD' IS**  
14 **DEFINED TO INCLUDE BOTH SHARED AND COMMON COSTS". HE**  
15 **FURTHER MAINTAINS THAT "THE 'OVERHEAD LOADING' THAT IS TO BE**  
16 **EVALUATED PURSUANT TO THE NEW SERVICES TEST IS THE AMOUNT**  
17 **IN EXCESS OF THE CALCULATED DIRECT COST". WOULD YOU**  
18 **COMMENT ON WHAT IS A REASONABLE AMOUNT OF OVERHEAD?**

19  
20 **A.** In the context of a "new services" test analysis, a reasonable level of overhead  
21 means that BellSouth's service rate levels must fall within a range of cost/price  
22 ratios that have previously been accepted by the FCC for interstate filings. As I  
23 pointed out in my direct testimony, in deciding whether a service meets the "new

1 services" test, the FCC considers cost/price ratios for the services in question.  
2 The cost/price ratios of BellSouth's Payphone Service Provider ("PSP") services  
3 are within the cost/price ratios previously accepted by the FCC. One example of  
4 a cost/price ratio approved by the FCC is reflected in FCC 97-392 Order at ¶ 10,  
5 11, fn.39 where the FCC found that Bell Atlantic's revised ratios for payphone  
6 features which are as high as 3.4 times the direct costs are not unreasonable  
7 and meet the "new services" test and also found that another rate which  
8 exceeded direct costs by 38 percent met the "new services" test. Further, in DA  
9 97-1396 the FCC found that a rate that exceeded direct costs by 100 percent  
10 was reasonable and did not raise questions of lawfulness under the "new  
11 services" test. (CC Docket No. 97-140, 13 FCC Rcd 4241, DA 97-1396 (rel. July  
12 2, 1997) ¶¶ 5,7)

13  
14 There is no uniform overhead loading required to meet the "new services" test  
15 (FCC 97-392 Order at ¶ 13). As previously shown, and as discussed in Dr.  
16 Taylor's testimony, it is and has been recognized by the FCC that certain  
17 services may recover more or less overhead costs than other services. (FCC 97-  
18 392 Order at ¶ 13)

19  
20 An example of a cost/price ratio accepted by the FCC for a BellSouth service is a  
21 November 24, 1997, filing to introduce a new service option for BellSouth  
22 Fastpacket Access Services, which reflects unit cost/unit price ratios for various  
23 rate elements from .10 to .33. Another FCC filing on this same day to introduce



1 a new service option for Uncompressed Switched Video Service shows a  
2 cost/price ratio of .70. Another example of various FCC-accepted cost/price  
3 ratios is evidenced in BellSouth's July 9, 1996, filing to introduce a new optional  
4 payment plan for LightGate® service and SMARTRing® service which reflects  
5 unit cost/unit price ratios for various rate elements from .02 to .93.

6  
7 Another example of a cost/price ratio accepted by the FCC for a BellSouth  
8 service is a July 6, 1999 filing to expand the availability of SMARTGate service  
9 and BellSouth Managed Shared Ring Network to the states of Alabama and  
10 North Carolina that reflects cost/price ratios of .67 and .68 respectively for these  
11 services.

12  
13 A filing on May 4, 1999 revising BellSouth Dedicated Ring service for Switched  
14 Access to include the state of Louisiana shows a cost/price ratio of .32. Another  
15 example of various FCC-accepted cost/price ratios is evidenced in BellSouth's  
16 November 20, 1998 filing to establish SMARTGate switched access rate  
17 elements for its SONET based transport services which reflects cost/price ratios  
18 of .72 and .20.

19  
20 Other FCC tariffed rates for "new services" reflect similar variations in overhead  
21 levels. These examples of FCC-accepted cost/price ratios show that the  
22 cost/price ratios of .40 and .38 for Public Telephone Access Service ("PTAS")  
23 and SmartLine® Service in Tennessee, respectively fall within a range of

1 cost/price ratios that have been accepted by the FCC in interstate filings. My  
2 testimony demonstrates that BellSouth's existing rates for PTAS and  
3 SmartLine® service meet the requirements of the "new services" test.

4  
5 **Q. BEGINNING ON PAGE 20 OF HIS TESTIMONY MR. WOOD DISCUSSES THE**  
6 **EUCL AND PICC EXTENSIVELY AND THEIR APPLICABILITY IN**  
7 **DETERMINING APPROPRIATE RATES FOR INTRASTATE PAYPHONE**  
8 **SERVICES. PLEASE RESPOND.**

9  
10 **A.** The End User Common Line ("EUCL"), sometimes referred to as the Subscriber  
11 Line Charge ("SLC"), is a fee collected by LECs to recover a portion of the  
12 interstate costs associated with providing local telephone service. Because  
13 these fees are related to interstate costs, they are governed by the FCC. The  
14 FCC concluded that "... to avoid discrimination among payphone providers, the  
15 multi-line business SLC must apply to subscriber lines that terminate at both LEC  
16 and competitive payphones". (See CC Docket No. 96-128 FCC's Report and  
17 Order, adopted and released on September 20, 1996, at p. 187). Subsequently,  
18 the FCC stated "BellSouth contends there is no subsidization, because the SLC  
19 serves the purpose of recovering regulated costs associated with payphones.  
20 We agree with BellSouth that the application of a SLC to payphone lines is  
21 necessary for LECs to recover regulated costs assigned to the interstate  
22 jurisdiction. In addition, SLC charges will apply to LEC and non-LEC payphone  
23 lines, and therefore, the incremental SLC cost is the same for a LEC and non-

1 LEC payphone provider". (See FCC's Order on Reconsideration, adopted and  
2 released on November 8, 1996 in CC Docket No. 96-128, at p. 207). Earlier this  
3 year, the FCC stated "we note that amendments made to the Commission's  
4 rules following passage of the Telecommunications Act of 1996 mandate that  
5 both independent payphone providers and the LECs pay the EUCL charge for all  
6 of their payphones". (See FCC's Memorandum Opinion and Order on Remand,  
7 adopted on April 7, 2000 and released on April 13, 2000, in File Nos. E-89-170,  
8 et. al., at p.8).

9  
10 Like the EUCL, the Presubscribed Interexchange Carrier Charge ("PICC") is an  
11 FCC authorized fee to help offset the costs incurred by LECs when they  
12 complete calls for Interexchange Carriers ("IXCs"). This fee is billed to the PSP's  
13 presubscribed IXC, except when the PSP has elected not to select a  
14 presubscribed IXC, in which case the PICC is billed to the PSP. The PICC, like  
15 the EUCL charge, is a federally authorized fee, and as such, and should be  
16 treated consistently with the EUCL charge.

17  
18 **Q. IN MR. WOOD'S TESTIMONY, HE QUOTES EXTENSIVELY FROM THE**  
19 **FCC'S COMMON CARRIER BUREAU'S ("CCB'S") "WISCONSIN ORDER"**  
20 **AND STATES THAT THE WISCONSIN ORDER ANSWERS THE QUESTION**  
21 **"WHAT WOULD THE FCC REQUIRE THE LECs TO DEMONSTRATE (AND**  
22 **WHAT INFORMATION WOULD BE SPECIFICALLY REQUIRED TO BE**  
23 **PROVIDED) IF THE FCC WERE TO APPLY ITS OWN STANDARDS TO THE**

1       **RATES FOR PAYPHONE ACCESS SERVICE?" PLEASE RESPOND TO**  
2       **THIS.**

3  
4    A.   Any reliance of Mr. Wood's testimony on the Wisconsin Order is misplaced. If  
5       sections of Mr. Wood's testimony are consistent with the Wisconsin order, then  
6       these parts of his testimony are at odds with the prior FCC payphone orders  
7       issued by the full FCC. The Wisconsin Order is not a final order of the FCC, and  
8       its very application is subject to a request for Stay, filed by the LEC Coalition on  
9       April 3, 2000. Moreover, the LEC Coalition has also applied for review of the  
10      CCB's Order, and has replied to oppositions to its applications for review and  
11      stay. Mr. Wood acknowledges that the Wisconsin Order applies only to the four  
12      Wisconsin LECs identified in the order. For the TPOA to rely on the Wisconsin  
13      Order is inappropriate.

14  
15     The FCC exercised jurisdiction over the payphone issue in Wisconsin only  
16     because the Wisconsin Public Service Commission found that it lacked  
17     jurisdiction "under state law to address whether the rates, terms and conditions  
18     applicable to the provision of basic payphone lines comply with Section 276 of  
19     the Act". Due to the fact that the TRA has accepted jurisdiction in the payphone  
20     docket, the instant situation bares little, if any, resemblance to the Wisconsin  
21     case, and therefore reliance upon the CCB's Wisconsin order is inappropriate.

1 The FCC's jurisdiction of payphones is based on Section 276 of the Telecom  
2 Act. Section 276 of the Telecom Act gave rise to the original FCC Payphone  
3 Order and subsequent Order on Reconsideration. These orders require retail  
4 payphone access line rates to be cost based and to comply with the FCC's "new  
5 services" test. They do not, however, require the use of Unbundled Network  
6 Element ("UNE") cost elements in setting cost-based rates. By effectively  
7 allowing LECs to set payphone prices at UNE-based rates, the Wisconsin Order  
8 conflicts with 1996 Telecom Act, with prior FCC orders and sensible policy. If  
9 LECs were required to provide payphone services at UNE rates, it would virtually  
10 foreclose Competitive Local Exchange Company ("CLEC") competition in the  
11 market for payphone service. PSPs are not CLECs nor do they have the  
12 regulatory obligations associated with being a CLEC.

13  
14 Further, concerning the Wisconsin order, the State Corporation Commission of  
15 the State of Kansas issued a July 17, 2000 Order regarding a formal complaint  
16 filed by the Kansas Payphone Association ("KPA") against Southwestern Bell  
17 Telephone, alleging that its PTAS rates were unreasonable, unfair, unjust and  
18 discriminatory. The Kansas Commission dismissed KPA's complaint. In its  
19 analysis, the Kansas Commission cited with approval its staff's view that "KPA  
20 reads too much" into the Common Carrier Bureau's Wisconsin Order, and that  
21 "the Order applies only to the four Wisconsin LECs". BellSouth submits that the  
22 Kansas Commission's reasoning is sound and equally applicable to the  
23 Tennessee case.

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**Q. ON PAGE 38 OF HIS TESTIMONY, MR. WOOD STATES THAT ANY NEW RATES DEVELOPED BY THE TRA FOR PAYPHONE SERVICES SHOULD BE MADE EFFECTIVE RETROACTIVELY TO APRIL 15, 1997. DO YOU AGREE WITH THIS?**

**A. Yes. The Payphone Orders require that the LECs have payphone rates that meet the “new services” test in effect by April 15, 1997.**

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

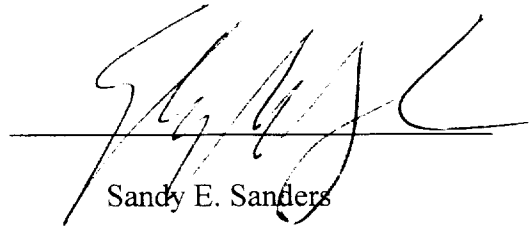
**A. Yes**

AFFIDAVIT

STATE OF: Georgia  
COUNTY OF: Fulton

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Sandy E. Sanders - Manager-Federal Regulatory, BellSouth Telecommunications, Inc., who, being by me first duly sworn deposed and said that:

He is appearing as a witness before the Tennessee Regulatory Authority in Docket No. 97-00409 on behalf of BellSouth Telecommunications, Inc., and if present before the Authority and duly sworn, his testimony would be set forth in the annexed testimony consisting of   1   pages and   C   exhibit(s).

  
Sandy E. Sanders

Sworn to and subscribed  
before me on 2<sup>nd</sup> Oct

  
NOTARY PUBLIC

**MICHEALE F. HOLCOMB**  
Notary Public, Douglas County, Georgia  
My Commission Expires November 3, 2001

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**BELLSOUTH TELECOMMUNICATIONS, INC.**  
**REBUTTAL TESTIMONY OF D. DAONNE CALDWELL**  
**BEFORE THE TENNESSEE REGULATORY AUTHORITY**  
**DOCKET NO. 97-00409**  
**OCTOBER 6, 2000**

**Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

A. My name is D. Daonne Caldwell. My business address is 675 W. Peachtree St., N.E., Atlanta, Georgia. I am a Director in the Finance Department of BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth"). My area of responsibility relates to the development of economic costs.

**Q. ARE YOU THE SAME D. DAONNE CALDWELL THAT FILED DIRECT TESTIMONY IN THIS DOCKET?**

A. Yes. I filed direct testimony on September 15, 2000.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A. The purpose of my testimony is to reply to certain cost-related comments made by Tennessee Payphone Owners Association witness, Mr. Don Wood.

**Q. ON PAGE 10, MR. WOOD ASSERTS THAT THERE ARE THREE**



1           **CATEGORIES OF COST THAT MUST BE CONSIDERED. FROM A**  
2           **COST DEVELOPMENT PERSPECTIVE, IS HE CORRECT?**

3  
4       A. No. Mr. Wood states that “[t]he Authority will need to examine three categories of  
5       cost: direct, shared, and common.” As I explained in my direct testimony, the cost  
6       methodology used by BellSouth identified only the direct costs of the service. This  
7       Total Service Long Run Incremental Cost (“TSLRIC”) methodology is appropriate  
8       for use in assuring that the service is not being subsidized by any other product or  
9       service, i.e., as long as the rate is above TSLRIC then the service is not being  
10      subsidized. Thus, it provides the appropriate foundation when establishing rates  
11      for competitive services. There is no value in identifying shared and common  
12      costs for each service in a multi-product firm since it would be based on some  
13      arbitrary allocation of costs.

14  
15      **Q. ON PAGE 17, MR. WOOD ADVOCATES USING UNBUNDLED**  
16      **NETWORK ELEMENT (“UNE”) COSTS TO DEVELOP THE COSTS FOR**  
17      **PAYPHONE ACCESS SERVICES. IS THIS NECESSARY?**

18  
19      A. No. First, Bellsouth is under no obligation to revert to the unbundled network  
20      element results every time a service cost study is required. Second, the cost study  
21      filed in this docket reflects the characteristics and network configuration specific to  
22      payphone access service. Thus, the features, number of calls, holding time per  
23      call, and loop length are reflective of payphone access service.

24  
25      On page 18, Mr. Wood lists certain adjustments he feels would be needed if the

1 UNE costs are utilized: (1) remove unbundling costs, (2) reflect payphone access  
2 service characteristics, and (3) recognize potentially duplicative charges. Because  
3 BellSouth's costs were not based on elements that had been unbundled, however,  
4 there are no "unbundling" costs to remove. Further, as I have discussed  
5 previously, the study was conducted for payphone access service, thus the  
6 characteristics of the payphone access line are already considered in the cost study.  
7 Mr. Sanders will address Mr. Wood's third point, i.e., the alleged "duplicative"  
8 charges.

9  
10 **Q. YOU MENTIONED THAT LOOP LENGTH WAS SPECIFICALLY**  
11 **CONSIDERED IN BELL SOUTH'S COST STUDY. ON PAGE 19, MR.**  
12 **WOOD STATES THAT THE LOOP LENGTH SHOULD REFLECT ONLY**  
13 **BUSINESS LINE CHARACTERISTICS. IS HE CORRECT?**

14  
15 A. No. Mr. Wood is absolutely wrong. The loop length should equate to the average  
16 length of a payphone access line, not a business line. This is as I explained in my  
17 direct and is exactly what BellSouth has done. A sample of payphone access lines  
18 was drawn and the average loop length was determined from that sample.

19  
20 Mr. Wood's claim that BellSouth will only process a payphone access line order  
21 for a business address is true, but this restriction has to do with class of service  
22 limitations, not the physical attributes of the line. Payphones are often located in  
23 "residential" settings; pool houses/ clubhouses, public housing, and trailer parks.  
24 Thus, Mr. Wood's claim should be disregarded.

1     **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2

3     A. Yes.

AFFIDAVIT

STATE OF: Georgia  
COUNTY OF: Fulton

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared D. Daonne Caldwell – Director –Finance, BellSouth Telecommunications, Inc., who, being by me first duly sworn deposed and said that:

She is appearing as a witness before the Tennessee Regulatory Authority in Docket No. 97-00409 on behalf of BellSouth Telecommunications, Inc., and if present before the Authority and duly sworn, his testimony would be set forth in the annexed testimony consisting of 4 pages and 0 exhibit(s).

D. Daonne Caldwell

D. Daonne Caldwell

Sworn to and subscribed  
before me on 2<sup>nd</sup> Oct

Micheale F. Holcomb  
NOTARY PUBLIC

**MICHEALE F. HOLCOMB**  
Notary Public, Douglas County, Georgia  
My Commission Expires November 3, 2001

**REBUTTAL TESTIMONY OF WILLIAM E. TAYLOR, Ph.D.**

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**DOCKET NO. 97-00409**

**OCTOBER 6, 2000**

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT**  
2 **POSITION.**

3 A. My name is William E. Taylor. I am Senior Vice President of National Economic Research  
4 Associates, Inc. ("NERA"), head of its Communications Practice, and head of its  
5 Cambridge office located at One Main Street, Cambridge, Massachusetts 02142.

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL, PROFESSIONAL, AND BUSINESS**  
7 **EXPERIENCE.**

8 I have been an economist for over twenty-five years. I earned a Bachelor of Arts degree  
9 from Harvard College in 1968, a Master of Arts degree in Statistics from the University of  
10 California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in  
11 Industrial Organization and Econometrics. For the past twenty-five years, I have taught and  
12 published research in the areas of microeconomics, theoretical and applied econometrics,  
13 which is the study of statistical methods applied to economic data, and telecommunications  
14 policy at academic and research institutions. Specifically, I have taught at the Economics  
15 Departments of Cornell University, the Catholic University of Louvain in Belgium, and the  
16 Massachusetts Institute of Technology. I have also conducted research at Bell Laboratories  
17 and Bell Communications Research, Inc.

18 I have participated in telecommunications regulatory proceedings before many state  
19 public service commissions, including the former Tennessee Public Service Commission  
20 and the Tennessee Regulatory Authority ("Authority"). In addition, I have filed affidavits  
21 before the Federal Communications Commission ("FCC") and the Canadian Radio-  
22 television Telecommunications Commission on matters concerning incentive regulation,  
23 price cap regulation, productivity, access charges, local competition, interLATA  
24 competition, interconnection and pricing for economic efficiency. Recently, I was chosen by

1 the Mexican Federal Telecommunications Commission and Telefonos de Mexico  
2 ("Telmex") to arbitrate the renewal of the Telmex price cap plan in Mexico.

3 I have also testified on market power and antitrust issues in federal court. In recent  
4 years, I have studied—and testified on—the competitive effects of mergers among major  
5 telecommunications firms and of vertical integration and interconnection of  
6 telecommunications networks.

7 Finally, I have appeared as a telecommunications commentator on PBS Radio and on  
8 The News Hour with Jim Lehrer. My curriculum vita is attached as Exhibit WET-1.

9 **Q. PLEASE DESCRIBE NERA, YOUR PLACE OF EMPLOYMENT.**

10 A. Founded in 1961, National Economic Research Associates or NERA is an internationally  
11 known economic consulting firm. It specializes in devising economic solutions to problems  
12 involving competition, regulation, finance, and public policy. Currently, NERA has more  
13 than 275 professionals (mostly highly experienced and credentialed economists) with 10  
14 offices in the U.S. and overseas offices in Europe (London and Madrid) and Sydney,  
15 Australia. In addition, NERA has on staff several internationally renowned academic  
16 economists as Special Consultants who provide their professional expertise and testimony  
17 when called upon.

18 The Communications Practice, of which I am the head, is a major part of NERA. For  
19 over 30 years, it has advised a large number of communications firms both within and  
20 outside the U.S. Those include several of the regional Bell companies and their  
21 subsidiaries, independent telephone companies, cable companies, and telephone operations  
22 abroad (e.g., Canada, Europe, Japan and East Asia, Australia, and South America). In  
23 addition, this practice has supported a large number of legal firms and the clients they  
24 represent, and routinely provided testimony or other input to governmental entities like the  
25 FCC, the Department of Justice, the U.S. Congress, several state regulatory commissions,  
26 and courts of law. Other clients include industry forums like the United States Telephone  
27 Association.

28 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

1 A. I have been asked by BellSouth Telecommunications ("BST") to review and comment on  
2 the economic and regulatory issues raised in the testimony of Don Wood, on behalf of the  
3 Tennessee Payphone Owners Association ("TPOA"). At issue primarily are (i) how  
4 payphone access line services provided by BST to independent payphone service providers  
5 ("PSPs") in Tennessee should be priced, and (ii) whether those prices conform to the  
6 statutory requirements of the Telecommunications Act of 1996 ("TA 96") and the standards  
7 established by the FCC to implement those requirements.

8 **Q. PLEASE SUMMARIZE YOUR POSITION ON THOSE ISSUES.**

9 A. Mr. Wood describes standards to be applied when evaluating the appropriateness of BST's  
10 rates for payphone access services, including the FCC's multi-part test. Upon careful  
11 consideration of the issues raised in his testimony (especially in light of the record  
12 developed by the FCC on those matters), I conclude that BST's tariffed rates in Tennessee  
13 (i) satisfy all statutory requirements, (ii) are fair and reasonable, (iii) conform to efficient  
14 pricing principles, and (iv) do not portend ill for the growth of the payphone market in the  
15 state.

16 **Q. HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?**

17 A. This rebuttal testimony is composed of three parts. First, I provide some background  
18 information about the payphone industry that is germane to my subsequent discussion of the  
19 economic issues raised in the testimonies of Mr. Wood. Second, I demonstrate Mr. Wood  
20 has either misunderstood or made errors in analyzing several aspects of the statutory  
21 requirements that BST's rates for payphone services must satisfy for the Authority to  
22 reaffirm them. Third, I provide conclusions based on my analysis.

23 **Q. PLEASE DESCRIBE THE CHARACTERISTICS OF TELEPHONE SERVICE**  
24 **PROVIDED THROUGH PAYPHONES.**

25 A. Payphones may be used to place (and sometimes receive) most kinds of telephone calls that  
26 are traditionally made from privately-owned telephones by residential and business  
27 subscribers to the public switched network. However, payphones differ from privately-  
28 owned telephones in some important respects.

- 1       1. Unlike privately-owned telephones, payphones are owned and maintained by PSPs.
- 2       2. PSPs install their payphones on property provided—typically, commercially leased—by
- 3       “location providers.” Privately-owned telephones are typically located on the premises
- 4       of the telephone owners themselves.
- 5       3. Payphone service typically involves four parties: the PSP that owns the payphone, the
- 6       location provider that provides the site for installing the payphone, the
- 7       telecommunications carriers that actually carry calls from the payphone to their eventual
- 8       destinations, and the payphone user. In contrast, service from privately-owned
- 9       telephones only involves two parties: the telephone owner and the carriers used to place
- 10      and receive calls.
- 11      4. Unlike privately-owned telephones for which services are typically billed on a monthly
- 12      basis, payphone users must pay at the time they make their calls.

13           Just like privately-owned telephones, payphones may be used to make local, long

14      distance toll, and toll-free (800 number) calls. However, payphone users have the option of

15      either paying in cash (i.e., receive service on a “coin” basis) or charging to telephone calling

16      cards or other parties (i.e., receive service on a “coinless” basis).

17           Payphones are typically presubscribed to designated interexchange carriers (“IXCs”) or

18      operator service providers (“OSPs”) for the carriage of inter- and intrastate long distance

19      calls or to designated local exchange carriers (“LECs”) for the carriage of local and

20      intrastate long distance calls.<sup>1</sup> The payphone owners, i.e., the PSPs, may, therefore, not be

21      telecommunications carriers themselves. As I explain below, this fact has an important

22      bearing on the structure of the payphone market. It also means that revenue earned from

23      payphone users are shared among three parties: the carriers, the PSPs, and the location

24      providers (who receive commissions).

25      **Q. PLEASE DESCRIBE THE STRUCTURE OF THE PAYPHONE MARKET.**

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<sup>1</sup> OSPs are usually IXCs that provide operator-assisted long distance service. They may be “presubscribed” (i.e., OSPs to whom long distance payphone calls would be automatically sent) or “non-presubscribed” (i.e., OSPs whom payphone callers may reach by use of special access codes). An access code is a sequence of numbers that needs to be dialed to connect the caller to the OSP associated with that sequence, as opposed to the OSP presubscribed to the originating line. Access codes include 1010XXX in equal access areas and “950” Feature Group B dialing (950-0XXX or 950-1XXX) anywhere, where the three-digit XXX denotes a particular IXC. Some OSPs use an 800 number as an access code. Dial around calls are all calls that bypass any presubscribed carrier. The Telephone Operator Consumer Services Improvement Act (“TOCSIA”) of 1990 prohibits PSPs from blocking access to non-presubscribed OSPs (by access code or dial around calls) by payphone users.



1 A. In order to assemble its retail payphone service, an PSP must use an access line to connect  
2 its payphone set to the public switched network (at a central office) and provide local usage  
3 services and various features (e.g., central office blocking and screening and, optionally,  
4 billed number screening). Although, from an economic standpoint, the access line and  
5 other services/features would appear to be intermediate goods, i.e., resources needed to  
6 support payphone use, they are customarily viewed as tariffed *business* exchange services  
7 and the PSPs themselves as (retail) business end-users.

8 As explained by BST witness Sandy Sanders, in Tennessee, BST provides these  
9 components of payphone service in two forms: Public Telephone Access Service (“PTAS”)  
10 and Smartline<sup>®</sup> service.<sup>2</sup> Traditionally, Tennessee PSPs have purchased these services from  
11 BST, the *incumbent* LEC. However, as *competitive* LECs (“CLECs”) expand their  
12 operations in the state, the access line services needed for payphone service are becoming  
13 increasingly available from non-BST sources.<sup>3</sup>

14 PTAS and Smartline<sup>®</sup> are both tariffed business services that have traditionally been  
15 priced at or near the level of rates for *business* local exchange service. Those prices have  
16 also included contribution toward BST’s shared and common costs.

17 **Q. WHY DO PRICES OF SERVICES LIKE PTAS AND SMARTLINE<sup>®</sup> INCLUDE**  
18 **CONTRIBUTION TOWARD BST’S SHARED AND COMMON COSTS?**

19 A. As also explained by BST witness Daonne Caldwell, there are broadly two types of cost: (i)  
20 direct incremental cost that is incurred when adding or expanding the provision of a specific  
21 service (such as PTAS or Smartline<sup>®</sup>), and (ii) shared cost that is not specific to any single  
22 service but arises in the process of adding or expanding the provision of several services. A  
23 common cost is simply a cost that is shared by *every* service, e.g., that arising from

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<sup>2</sup> Direct Testimony of Sandy E. Sanders in this proceeding, September 15, 2000. Mr. Sanders explains that PTAS is designed to work with “smart” payphone sets equipped with software for rating calls, collecting coins, and diagnosing maintenance problems. In contrast, Smartline<sup>®</sup> is designed to work with “dumb” payphone sets, i.e., those which rely on central office-based software for carrying out the same functions.

<sup>3</sup> CLEC competition is growing in Tennessee. It is my understanding that, as of August 2000, at least 75 CLECs (a mix of facilities-based carriers and resellers) were certificated to operate in the state. Mr. Sanders also states that, as of August 2000, 291 PSPs operated in the state of Tennessee. Direct testimony of Sandy Sanders, at 15.

1 administrative, legal, human resources, and financial functions. Shared and common costs  
2 are sometimes referred to as *overhead* costs: unlike direct incremental costs, they cannot be  
3 identified with specific services.

4 While it is economically efficient for service prices to be set as close to underlying  
5 incremental costs as possible, in certain capital-intensive industries like telecommunications  
6 that form of pricing is simply not feasible.<sup>4</sup> In those industries, firms typically experience  
7 relatively high fixed (i.e., volume-insensitive) and shared and common costs and relatively  
8 low service-specific incremental costs. Setting prices to recover only those incremental  
9 costs would, therefore, prevent firms from recovering their substantial shared and common  
10 costs and from breaking even (making a normal return on capital). In those circumstances,  
11 economic theory prescribes specific rules (which I discuss at length later in my testimony)  
12 for marking service prices above incremental costs so as to recover *all* costs in an  
13 economically efficient manner. This is the rationale for including contribution toward  
14 shared and common costs in the prices of PTAS and Smartline<sup>®</sup> service.

15 **Q. IS THE PAYPHONE INDUSTRY COMPETITIVE TODAY?**

16 A. Yes. Retail payphone service has been declared to be competitive by the FCC, although it  
17 has not yet been freed totally from all federal or state regulation. At Divestiture in 1984  
18 (when the old Bell System was broken up under a consent decree), payphone service was  
19 considered a part of basic local service and assigned entirely to the Bell Operating  
20 Companies (“BOCs”)—of which BST is one—rather than to AT&T or other IXC. The  
21 advent of smart payphones in the mid-1980’s and a subsequent FCC reclassification of  
22 smart payphones as terminal equipment rather than network elements led to the emergence  
23 of non-LEC providers of payphone service. In the years since, almost 1.75 million LEC  
24 payphones have been placed in service nationwide,<sup>5</sup> and the number of PSP payphones has

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<sup>4</sup> The discussion here focuses on *services*, not network elements. I return to this distinction later in my testimony.

<sup>5</sup> Source: FCC Common Carrier Bureau, *Statistics of Communications Common Carriers*, 1998/99 edition, Table 2.10.

1 long since surpassed 350,000.<sup>6</sup>

2 Even though retail payphone service is competitive, the FCC retains authority over  
3 several aspects of their operation. Since the passage of TA 96, the FCC has issued a series  
4 of orders (collectively the *Payphone Orders*)<sup>7</sup> implementing the provisions of Section 276  
5 of TA 96 that affect various aspects of the payphone industry. In the course of issuing these  
6 orders in 1996 and 1997, the FCC stated and reaffirmed its belief that the payphone industry  
7 is competitive. For example:

8 ... the payphone industry has the potential to be very competitive. Entry into the  
9 payphone business appears to be easy. The ability to purchase a payphone,  
10 secure a location contract, obtain a payphone line from the LEC, and maintain  
11 the payphone are, together, the minimal technical requirements to enter into the  
12 payphone business. In addition, payphone lines are part of the tariffed offerings  
13 of local exchange carriers and, in some jurisdictions, only a simple business line  
14 is required to the [sic] payphone service. As contracts come up for renewal, or  
15 as location providers find it economical to put in new payphones, PSPs  
16 [payphone service providers] and [IXCs] routinely make themselves available to  
17 negotiate new agreements among themselves and the location provider.

18 A payphone can be removed and used at another location, which facilitates entry  
19 and exit. If a PSP can easily redeploy its assets, it will be more willing to place a  
20 payphone in response to a small increase in price, because the risk of such  
21 placement is lower. In addition, there appear to be no significant scale or scope  
22 economies or network externalities that would impede entry of new firms. As a  
23 result, barriers to entry appear to be very low. In fact a large number of firms,  
24 both large and small, have entered the industry since it was initially opened to  
25 competition in 1984, and those firms have provided competition in at least some  
26 segments of the payphone market.<sup>8</sup>

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<sup>6</sup> Source: FCC, *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Notice of Proposed Rulemaking ("NPRM"), released June 6, 1996, ¶ 6 (citing an *ex parte* letter, dated April 24, 1996, from Cincinnati Bell to the Common Carrier Bureau).

<sup>7</sup> FCC, *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Report and Order ("FCC 96-388 Order"), released September 20, 1996; Order on Reconsideration ("FCC 96-439 Order"), released November 8, 1996; Order (Common Carrier Bureau DA 97-678, "Bureau Waiver Order"), released April 4, 1997; Order (Common Carrier Bureau DA 97-805, "Second Bureau Waiver Order"), released April 15, 1997; Second Report and Order ("FCC 97-371 Order"), released October 9, 1997.

<sup>8</sup> FCC 96-388 Order, ¶¶ 11-12. (Footnotes omitted)

**Q. GIVEN THE FCC'S FINDING THAT PAYPHONE SERVICE IS COMPETITIVE,  
HOW HAVE ITS ACTIONS TAKEN THROUGH THE PAYPHONE ORDERS  
AFFECTED THE PAYPHONE INDUSTRY?**

A. As I explain in greater length later in my testimony, through its *Payphone Orders* the FCC has laid out a roadmap for eventually removing all regulation and tariffing requirements from the payphone industry. Its finding that the industry is currently competitive and has the potential to become even more so has prompted the FCC to initiate steps to further reduce entry barriers in this industry. The FCC has taken four specific steps.

First, acting on the mandate provided by Section 276 of TA 96 (discussed later), the FCC has decreed that BOC-owned and operated payphones be reclassified as customer premises equipment ("CPE") rather than as network elements, and separated from the payphone access and usage services (such as PTAS and Smartline<sup>®</sup>) that are available from BOCs. Such unbundling is intended to prevent any cross-subsidization of BOC payphone service by other BOC services like basic exchange and exchange access.<sup>9</sup>

Second, the FCC has retained tariffing requirements for BOC-provided payphone access and usage services, particularly where a BOC is itself a provider of retail payphone service. As I discuss later in my testimony, those requirements (or *non-structural safeguards*) involve demonstrating that tariffed rates of payphone access and usage services are cost-based and non-discriminatory and that they pass the new services test to which all price-capped LECs are subject.<sup>10</sup>

Third, recognizing that its actions, and particularly the non-structural safeguards, eliminate the possibility of anti-competitive pricing of payphone access and usage services by BST and other BOCs (or incumbent LECs), the FCC has specifically and pointedly declined to adopt *structural* safeguards such as requiring that BOCs that also provide retail payphone service do so through separate affiliates (that maintain a separate corporate

<sup>9</sup> FCC 96-388 Order, ¶¶ 142-144.

<sup>10</sup> *Id.*, ¶ 146.

structure and accounting books from the BOCs themselves).<sup>11</sup>

Fourth, the FCC has specifically and pointedly declined to require that payphone access and usage services provided by BST and other incumbent LECs be subject to the same pricing regime that applies under Sections 251 and 252 of TA 96 to interconnection and unbundled network elements (“UNEs”).<sup>12</sup>

As for retail payphone service itself, the FCC has instituted per-call compensation mechanisms that would compensate PSPs that receive no revenue whenever payphone customers make toll-free (subscriber 800), dial around long distance (or access code), and debit card calls. Significantly, the FCC has declined to set per-call compensation rates on a cost plus markup basis, insisting instead that retail payphone competition should be trusted to produce efficient market-determined rates.<sup>13</sup>

**Q. PLEASE EXPLAIN WHAT SECTION 276 OF TA 96 ENVISIONS FOR PAYPHONE SERVICE.**

A. Section 276 of TA 96 requires, *inter alia*, that any BOC that provides payphone service: (i) shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations; and (ii) shall not prefer or discriminate in favor of its payphone service. These are the basis for several non-structural safeguards that the FCC has sought to implement through its *Payphone Orders*. As Mr. Sanders has pointed out in his testimony, the critical requirement is that a BOC’s tariffed rates for payphone access line services pass the “new services test” which evolved as a non-structural safeguard from the FCC’s *Computer III* docket.<sup>14</sup>

The new services test—which I describe below—subsumes three specific requirements: that the tariffed rates in question be (i) cost-based, (ii) consistent with the requirements of Section 276 with regard, e.g., to the removal of subsidies from basic exchange and

<sup>11</sup> *Id.*, ¶ 145.

<sup>12</sup> *Id.*, ¶ 147.

<sup>13</sup> *Id.*, ¶¶ 118-119 (especially, fn. 323).

<sup>14</sup> Amendment of Section 64.702 of the FCC’s Rules and Regulations (“Computer III”).

1 exchange access services, and (iii) non-discriminatory. Mr. Wood devotes a substantial  
2 part of his testimony to the claim that, by applying only the new services test to its  
3 payphone access line services, BST has somehow failed to address these three requirements.  
4 This charge is immaterial because it makes a distinction without a difference. The new  
5 services test cannot be passed without the three requirements also being satisfied.

6 **Q. WHAT DOES IT MEAN FOR A PRICE OR RATE TO BE "COST-BASED?"**

7 A. A price is said to be cost-based if it is set in some relationship to the underlying economic  
8 cost. In general, a cost-based rate is the sum of direct incremental cost and a market-  
9 determined markup that recovers other costs. At a minimum, a cost-based rate must recover  
10 the direct incremental cost.

11 **Q. DOES THAT MEAN THAT A COST-BASED PRICE SHOULD BE *EQUAL TO A***  
12 ***SPECIFIC MEASURE OF COST?***

13 A. No. A cost-based price may differ from a specific measure of cost for a number of reasons.  
14 For example, the price need not be equal to direct incremental cost because of the need to  
15 include a contribution toward shared and common costs. As I mentioned before, in certain  
16 industries like telecommunications, if all service prices were set exactly equal to their  
17 respective incremental costs, the firm would fail to recover all of its costs. Therefore, there  
18 are circumstances in which prices of services must deviate efficiently from their incremental  
19 costs in order for the firm to earn a normal return on its investment. Other special  
20 circumstances may warrant a greater degree of markup for prices above incremental cost.  
21 For example, in the present environment, LECs are obliged to price their residential basic  
22 exchange service below the incremental cost of that service. Sustaining such a price is only  
23 possible by including contribution toward residential basic exchange service in the prices of  
24 some or all of LECs' other services.

25 Basing a price on the underlying cost ensures that the price is cost-causative, i.e., what  
26 the customer is asked to pay depends on the cost of the resources that were specifically used  
27 to provide the service to the customer. A cost-based price also insures against anti-  
28 competitive behavior. For example, a price that is no less than the underlying incremental

1 cost cannot be predatory. Also, a price that is no less than the underlying total service long  
2 run incremental cost ("TSLRIC") cannot be receiving a cross-subsidy.<sup>15</sup> Thus, a firm that  
3 charges a price that is at least equal to incremental cost or TSLRIC cannot be pricing anti-  
4 competitively.

5 **Q. WHAT DOES IT MEAN FOR A PRICE TO CONFORM TO THE**  
6 **REQUIREMENTS OF SECTION 276 OF TA 96?**

7 A. Section 276 of TA 96 forbids the price (here, the prices of BST's payphone access line  
8 services, PTAS and Smartline<sup>®</sup>) from receiving a cross-subsidy from any basic exchange or  
9 exchange access service.

10 **Q. WHAT DOES IT MEAN FOR A PRICE TO BE NON-DISCRIMINATORY?**

11 A. Non-discrimination—another requirement of Section 276 of TA 96—implies that the  
12 provider of a service cannot charge different prices to different similarly-situated  
13 customers.<sup>16</sup> While price discrimination is fairly common in mature and competitive  
14 markets for retail services, Section 276's purpose here is to augment whatever protection is  
15 afforded by growing payphone service competition by prohibiting price discrimination for  
16 the payphone access line service that both a LEC and its competitor (a PSP) may use to  
17 provide payphone service.<sup>17</sup> This safeguard ensures that the LEC that supplies payphone  
18 access services does not derive an unfair advantage by charging its own payphone affiliate  
19 less for those services than it does its PSP competitors. However, as PSPs are increasingly  
20 able to acquire those services from non-BST sources, the *economic* significance of the non-  
21 discrimination requirement will decline.

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<sup>15</sup> In economic theory, incremental cost refers only to the additional cost of producing the next increment (or unit) of a service. TSLRIC refers to the additional cost of producing the entire volume of that service. By definition, that includes all variable and fixed costs specific to that service.

<sup>16</sup> A similar standard on price discrimination exists in Tennessee. For example, T.C.A. § 65-4-122(a) prohibits price discrimination "for service of a like kind under substantially like circumstances and conditions."

<sup>17</sup> Price discrimination is not inherently bad unless it confers on the price discriminating firm an unfair competitive advantage. For example, if a firm has monopoly control over an essential wholesale service which both it and its competitors must use to provide a retail service, then charging itself a lower price for the wholesale service than the price it charges its competitors can be an unfair and anti-competitive form of price discrimination.

**Q. WHAT IS THE NEW SERVICES TEST?**

A. The new services test is described in Part 61.49(f)(2) of the *Code of Federal Regulations*. It is more fully explained in an amendment of the FCC's Part 69 access charge rules<sup>18</sup> that enabled the BOCs to offer unbundled Open Network Architecture ("ONA") services. In its Order in that proceeding, the FCC modified the LEC Price Cap Order new services test to give "additional pricing flexibility to price cap local exchange carriers[.]"<sup>19</sup> As described in Part 61.49(f)(1-2), when a price cap LEC introduces a new service, it is required to submit cost data sufficient to establish that the new service will generate a "net revenue increase" and that the new service will not recover "more than a reasonable portion of the carrier's overhead costs." The purpose of this test is clearly to insure that the new service—here, PTAS or Smartline<sup>®</sup>—is not priced anti-competitively.

It is obvious that a price that passes the new services test must be cost-based because it would have to be set in some relationship to underlying cost, namely, at or above TSLRIC. A price that is at or above TSLRIC would also, by definition, not be cross-subsidized—by basic exchange, exchange access, or any other service—and, thus, conform to Section 276 of TA 96. Finally, it cannot be discriminatory if it applies equally to BST's own payphone affiliate and to that affiliate's PSP competitors.

**Q. HAS THE FCC DETERMINED A SPECIFIC IMPLEMENTATION OF THE NEW SERVICES TEST?**

A. No. While the FCC has addressed the issue on various occasions, it appears not to have settled on one definitive interpretation of the new services test. In most instances I am aware of, a showing that the price is some multiple (with a minimum of one) of the direct cost has—where uncontested—been sufficient to pass the test. Only in circumstances in which other parties have contested a LEC's proposed price, has the FCC felt compelled to

<sup>18</sup> *In the Matter of Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture Policy and Rules Concerning Rates for Dominant Carriers*, FCC 91-186, Report and Order, Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking ("FCC 91-186 Order"), CC Docket Nos. 89-79 and 87-313, released July 11, 1991.

<sup>19</sup> *Id.*, ¶ 1.



rule on whether the proposed price unreasonably exceeds the underlying direct cost.<sup>20</sup> Even then, the FCC has upheld prices significantly above direct cost, e.g., 3.4 times the direct cost for payphone features provided by the former Bell Atlantic.<sup>21</sup> This is sufficient reason for the Authority to interpret the new services test flexibly, based on appropriate economic reasoning and sound public policy.

**Q. IN YOUR OPINION, WHAT SHOULD THE AUTHORITY CONSIDER WHEN CONDUCTING THE NEW SERVICES TEST?**

A. There are, in my view, two important aspects to the new services test. The first concerns the choice of the cost standard that best measures the “direct cost” element of the new services test. The second concerns a determination whether the markup or overhead loading by which the tariffed rate exceeds the direct cost is reasonable.

**Q. HAS THE FCC EVER REQUIRED THE ADOPTION OF A SPECIFIC COST STANDARD FOR THE NEW SERVICES TEST?**

A. No. Apart from ruling out one specific cost methodology (discussed below), the FCC has never clearly indicated what cost standard should be selected for the purposes of the test. However, in the past it did state:

Under our approach, a LEC introducing new services will be required to submit its engineering studies, time and wage studies, or other cost accounting studies to identify the direct costs of providing the new service, absent overheads, and must also satisfy the net revenue test. ... LECs may develop their own costing methodologies, but they must use the same costing methodology for all related services.<sup>22</sup>

Even when the FCC had an opportunity in 1997 to revisit this issue, it issued no new

<sup>20</sup> For example, see FCC rulings on payphone-related tariff filings by Bell Atlantic and GTE in *In the Matter of Local Exchange Carriers' Payphone Functions and Features* (CC Docket No. 97-140), *Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 1* (Transmittal Nos. 962 and 966), *GTE System Telephone Companies Revisions to Tariff F.C.C. No. 1* (Transmittal Nos. 206 and 1112), *GTE System Telephone Companies Revisions to Tariff F.C.C. No. 1* (Transmittal Nos. 1095 and 217), Memorandum Opinion and Order (“FCC 97-392 Order”), released October 29, 1997.

<sup>21</sup> *Id.*

<sup>22</sup> FCC 91-186 Order, ¶ 42.

1 instructions.<sup>23</sup> That is in sharp contrast to the level of detail that the FCC has gone to in  
2 directing how a new cost methodology should be employed to determine costs and rates for  
3 UNEs (discussed below).

4 **Q. MR. WOOD [AT 12-13] APPEARS TO EQUATE THE AUTHORITY'S TASK IN**  
5 **THIS PROCEEDING TO THAT IN DOCKET NO. 97-01262 IN WHICH THE**  
6 **AUTHORITY WILL ESTABLISH COST-BASED RATES FOR UNBUNDLED**  
7 **NETWORK ELEMENTS. IS THAT A PROPER COMPARISON?**

8 A. Absolutely not. While there are some surface similarities between the tasks in that  
9 proceeding and the present one, it is dangerous to read too much into those similarities. It is  
10 true that cost-based and non-discriminatory rates needed to be established for UNEs in that  
11 proceeding, just as such rates need to be established for BST's payphone access line  
12 services in this proceeding. However, the cost standard on which rates for UNEs were to be  
13 based is *not* the same as the one that would apply in this proceeding.

14 Going by Sections 251 and 252 of TA 96, the FCC had interpreted the pricing rules  
15 therein to mean that prices of all UNEs should be set equal to their respective total *element*  
16 long run incremental costs ("TELRICs"). The FCC defined TELRIC to include "... the  
17 forward-looking costs directly attributable to the specified element, as well as a reasonable  
18 allocation of forward-looking common costs."<sup>24</sup> It is extremely important to understand that  
19 the TELRIC methodology that had also been adopted in Tennessee's Docket No. 97-01262  
20 does *not* apply in the current proceeding for the following reasons:

- 21 1. TELRIC pricing applies to unbundled network *elements*, not *services*. Elements are  
22 simply functionalities or network components that need to be combined in order to form  
23 telecommunications services. Those elements are of no value in and of themselves to  
24 end-users. Services, on the other hand, have value to end-users or other customers. As  
25 the FCC itself has recognized, services frequently share resources (e.g., retailing  
26 resources) and, therefore, have shared costs, whereas UNEs may have little shared costs.  
27 Therefore, the cost standard for UNEs, namely, TELRIC, is very different from the cost

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<sup>23</sup> FCC 97-392 Order.

<sup>24</sup> FCC, *In the Matter of Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order ("Local Competition Order"), released August 19, 1996, ¶ 682.

1 standard for services, namely, TSLRIC. In Docket No. 97-01262, the Authority had  
2 established TELRICs for UNEs, *not* TSLRICs for services.

3 2. As I pointed out earlier, the FCC has itself specifically *ruled out* the application of  
4 pricing rules from Sections 251 and 252 of TA 96 to tariffed rates for BOC payphone  
5 services.<sup>25</sup> Therefore, any reasonable costing methodology that is appropriate for  
6 services (e.g., BST's choice of TSLRIC or some other) would be consistent with the  
7 new services test, but *not* the TELRIC methodology or the framework provided by  
8 Sections 251 and 252 of TA 96.

9 **Q. HAS BST EMPLOYED THE PROPER COST STANDARD IN THIS**  
10 **PROCEEDING?**

11 A. Yes. In this proceeding, rates are being determined for two services, not elements.  
12 Therefore, for reasons stated above, the TELRIC cost standard is not appropriate. Instead,  
13 BST's choice of the TSLRIC cost standard is appropriate because TSLRIC measures direct  
14 cost (as required by the new services test) for the two services consistently with how that  
15 cost is caused. The FCC itself has been specific and direct in ruling out the application of  
16 UNE cost standards to payphone access line services, despite the recent directive from the  
17 Common Carrier Bureau. The Common Carrier Bureau issued a directive in March of this  
18 year that UNE cost standards be applied to payphone access and usage services.<sup>26</sup> The  
19 Common Carrier Bureau's directive was intended to apply only to four LECs providing  
20 payphone access line services in Wisconsin. While Mr. Wood apparently agrees with this  
21 fact [at 34-35], he is clearly not averse to taking a view of the directive that is more  
22 expansive than warranted when he remarks:

23 While the order is specific to four Wisconsin ILECs, it does serve to provide  
24 clarification in this case by answering the following question: What would the  
25 FCC require the LECs to demonstrate (and what information would be  
26 specifically required to be provided) if the FCC were to apply its own standards  
27 to the rates for payphone access service.

28 The fact of the matter is that, regardless of the pronouncements of the Deputy Chief of the

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<sup>25</sup> See footnote 12, *supra*.

<sup>26</sup> Common Carrier Bureau, *In the Matter of Wisconsin Public Service Commission Order Directing Filings*, CCB/CPD No. 00-1, released March 2, 2000.

Common Carrier Bureau, the FCC itself has never applied its TELRIC standards for UNEs to payphone services. In its *First Payphone Order* [at ¶147], the FCC made it perfectly plain that it rejected the requirement that “the pricing regime under Sections 251 and 252 apply to all Section 276 payphone services offered by incumbent LECs.” It also held that “the elements and services to be offered under Sections 251 and 252 are not available to entities that are not telecommunications carriers, and many [PSPs] are not telecommunications carriers.” Finally, it stated categorically that “Section 276 does not refer to or require the application of Sections 251 and 252 to LEC payphone services.”

**Q. HAS THE FCC PROVIDED SPECIFIC GUIDELINES ON WHAT WOULD CONSTITUTE A REASONABLE OVERHEAD LOADING IN A TARIFFED RATE THAT IS SUBJECT TO THE NEW SERVICES TEST?**

A. No. The FCC has not stated a precise methodology for determining a reasonable loading factor (i.e., the percent markup above direct costs). The Authority has the latitude to apply its own best judgment for determining the proper loading factor for all of BST’s services, including payphone services. A review of the previous FCC Orders, however, indicates that the FCC is interested in efficient pricing and in granting adequate flexibility. For example, at one point the FCC decided:

[t]o provide the flexibility needed to achieve efficient pricing, we are not mandating *uniform* loading, but BOCs will be expected to justify the loading methodology they select as well as any deviations from it.<sup>27</sup>

At a later time, the FCC reaffirmed this decision<sup>28</sup> and stated in addition:

Dramatic rate variance alone does not establish that individual rates are unreasonable.<sup>29</sup>

In fact, the FCC has broadly interpreted what constitutes a reasonable loading or markup.

In a more recent decision, the FCC once again stated that uniform loadings are not

<sup>27</sup> FCC 91-186 Order, ¶ 44.

<sup>28</sup> FCC, *In the Matter of Open Network Architecture Tariffs of Bell Operating Companies*, CC Docket No. 92-91, Order (“FCC 93-532 Order”), released December 15, 1993, ¶ 5.

required.<sup>30</sup> In that same Order, the FCC approved loadings as high as 4.8 times direct costs.

**Q. AS AN ECONOMIST, WHAT IS YOUR RECOMMENDATION TO THE  
AUTHORITY ABOUT HOW IT SHOULD DETERMINE WHAT A REASONABLE  
LOADING IS IN THIS CASE?**

A. For the purposes of this case, the Authority should be guided by economic efficiency and the effect of price changes on competition. From an economic perspective, welfare is maximized when demand considerations are taken into account to determine a proper markup above direct costs. It is a well-established economic principle that prices that are equal to their corresponding direct incremental costs result in economically efficient and welfare-maximizing outcomes. However, as I explained earlier in my testimony, due to considerable economies of scale and scope in telecommunications,<sup>31</sup> pricing at direct incremental cost leaves the regulated firm unable to recover its shared and common costs, often a significant portion of its total costs. As a result, markups above direct costs are needed.

Markups result in higher prices than would be the case without them. As a result, some demand may be suppressed—a condition called *allocative inefficiency*. This means that the Authority must strike a balance between the firm's (BST's) need to remain financially solvent by recovering all its costs and satisfying users' desire to get their services at the lowest possible prices (i.e., with minimum losses due to allocative inefficiency). Economic theory prescribes that such a balance be struck by setting markups in prices of different services in a way that minimizes consumer welfare losses due to allocative inefficiency.

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(...continued)

<sup>29</sup> *Id.*, ¶ 12.

<sup>30</sup> FCC 97-392 Order, ¶ 13.

<sup>31</sup> Economies of scale arise when the average incremental cost of providing a service falls as volume increases. This condition is usually associated with a situation I described earlier for capital-intensive firms: high fixed capital costs alongside low variable or incremental costs. Economies of scope arise when different services share resources. The more services share resources, the cheaper it is for a single firm to provide them together than for each service to be provided separately by different firms. LECs like BST display both economies of scale (because of their cost structure and the high volumes they serve) and economies of scope (because a multitude of different services are provided out of a common network where many facilities are shared in use).

The best known rule for that purpose is Ramsey Pricing (or some variant of it) according to which the markup in a service price should be inversely related to the market elasticity of demand<sup>32</sup> for that service.<sup>33</sup> In this way, a relatively higher markup on those services that are the least elastic in demand results in the least consumption loss (and allocative inefficiency) to society while ensuring that the service provider remains financially solvent. At the prices that result from the Ramsey pricing rule, customers would purchase services in the same proportions as they would if all prices were set equal to marginal cost in the absence of scale and scope economies.

The logic of this optimal markup rule makes two things perfectly clear:

1. Because the elasticity of demand varies among services (e.g., from payphone to various non-payphone services), there is *absolutely no economic support* for the proposition that loadings or markups should be the same or uniform in every service provided by a LEC. As I documented earlier, the FCC has also acknowledged this important fact.
2. In a firm the size of BST, the non-traffic-sensitive and shared and common costs are often the dominant component of total cost. Therefore, it should not be surprising that markups in prices directed to recover those costs could—depending on market demand conditions—end up being several multiples of the underlying direct incremental costs. “High” markups are *not*, on their face, unreasonable. Besides, markups are also subject to the market sustainability test. Markups that are unjustifiably high would also not be able to withstand competitive pressures. At any rate, in an industry in which *more* (rather than less) competition and reliance on market forces are being encouraged, it may be impossible—and ultimately, unnecessary—for a single regulatory agency like

<sup>32</sup> The elasticity of demand measures how sensitive customers are to changes in prices. The Law of Demand tells us that, other things being equal, price and demand move in opposite directions. However, a higher price may suppress demand a little, some, or a lot (and similarly with a lower price stimulating demand). When demand changes by *more* than the percentage change in price, then demand is called *elastic*. As the terminology suggests, the more elastic is demand, the more sensitive customers are to price changes (in either direction). When demand changes by *less* than the percentage change in price, then demand is *inelastic*. The polar case of the latter is *zero* elasticity when demand shows no sensitivity whatsoever to a price change.

<sup>33</sup> Ramsey pricing is named after its original proponent, economist Frank R. Ramsey. See his 1927 article, “A Contribution to the Theory of Taxation,” *Economic Journal*, 37, at 47-61. Ramsey pricing has stood the test of time, particularly for application in regulated industries. There are now several more sophisticated pricing rules based on Ramsey pricing (e.g., multi-part pricing) that provide economically efficient outcomes. In fact, there are several instances of Ramsey-like pricing in the real world even in deregulated or competitive industries in which firms experience economies of scale and scope. For example, in the competitive airline industry, passengers who have the flexibility to plan weeks in advance are, in effect, contributing less to an airline’s common costs (have lower markups in their prices) than business travelers who have less time to plan. Their ticket prices—even for the same class of service—may differ by several hundred dollars. That is just the way efficient markets work.

1 the FCC or the Authority with limited informational resources to try to second-guess the  
2 market with its multitude of complex interactions. That is why the FCC, in its wisdom,  
3 refrained—on several occasions—from spelling out precise boundaries on the markup  
4 that should be applied to each and every service that LECs provide. The “invisible  
5 hand” of a dynamic marketplace can perform that task far better.

6 **Q. WHAT SERVICES SHOULD BE CONSIDERED COMPARABLE TO PAYPHONE**  
7 **ACCESS LINE SERVICES?**

8 A. In order to judge the reasonableness of (the markups in) BST’s prices for its payphone  
9 access line services, it would be appropriate for the Authority to examine the prices (and the  
10 markups therein) of comparable services. According to the FCC, the services most  
11 comparable to payphone services are information or enhanced services, namely, those sold  
12 in adjacent markets that, like the payphone market, are also unregulated.<sup>34</sup> Enhanced  
13 service providers (“ESPs”), like PSPs, compete with incumbent LECs in those adjacent  
14 markets. Therefore, the overhead loadings in the payphone access line services that PSPs  
15 purchase may be compared to the overhead loadings in the business exchange services  
16 purchased by ESPs. One case, in particular, that the Authority may consider: the markup in  
17 the price of BST’s tariffed business access line and in the price of related usage service.

18 **Q. ARE UNES COMPARABLE SERVICES TO PAYPHONE LINE SERVICES?**

19 A. No. UNEs are not comparable to the payphone access line services in the sense explained  
20 above. PSPs do not compete with users of UNEs (generally, CLECs) in the provision of  
21 local exchange services. Unlike those CLECs, PSPs are generally not telecommunications  
22 carriers. Therefore, it is incorrect to suggest that the markup in payphone access line  
23 service prices should be comparable to that in UNE prices.

24 **Q. DO YOU BELIEVE THAT THE MARKUPS IN BST’S RATES FOR PTAS AND**  
25 **SMARTLINE® ARE REASONABLE?**

26 A. Yes. In light of BST’s cost structure and the FCC’s interpretation of what constitutes

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<sup>34</sup> NPRM, at ¶46, and *First Payphone Order*, at ¶145.

1 reasonable loadings (and, particularly, the absence of any requirements that loadings be  
2 uniform), I believe that the markups in BST's rates are reasonable.

3 **Q. MR. WOOD ARGUES [AT 22, 28-30] THAT CERTAIN ADJUSTMENTS MAY BE**  
4 **REQUIRED TO PAYPHONE ACCESS LINE RATES TO AVOID CREATING A**  
5 **SIGNIFICANT COMPETITIVE ADVANTAGE FOR BST. PLEASE RESPOND.**

6 A. First, Mr. Wood's analysis errs in thinking that the absolute *level* of the price of the  
7 payphone access line service can be the source of any unfair competitive advantage to BST.  
8 As long as both BellSouth's own payphone operations (conducted through a structurally  
9 separate affiliate called BellSouth Public) and the PSPs that purchase BST's payphone  
10 access line services all pay the same tariffed rates for those services, under identical terms  
11 and conditions, there can be no discrimination and, therefore, no unfair competitive  
12 advantage to BellSouth Public or BST. That would remain true no matter how high the  
13 rates for PTAS and Smartline<sup>®</sup> went. It is true, however, that higher payphone access line  
14 service prices would result in higher payphone service prices and, therefore, suppress some  
15 consumer demand. But, even though high PTAS and Smartline<sup>®</sup> prices may restrict the size  
16 of the payphone market, they will most assuredly not skew the terms of competitive  
17 engagement between BellSouth Public and independent PSPs. It is noteworthy that by  
18 creating a separate affiliate like BellSouth Public, the parent corporation (BellSouth  
19 Corporation) has *voluntarily* erected a structural safeguard and mitigated the prospects for  
20 unfair competition among retail payphone service providers. Even the FCC does not  
21 require the erection of such a structural safeguard.<sup>35</sup>

22 Second, given that the absolute level of price of the payphone access line service is  
23 irrelevant to the efficiency of the competitive process for the final payphone service, what  
24 matters only is the *margin* between the price that BellSouth Public pays to BST for the  
25 payphone access line and the final retail payphone service price that BellSouth Public  
26 charges its payphone customers. As long as that margin is at least equal to the BellSouth

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<sup>35</sup> FCC 96-388 Order, ¶ 199.



Public's incremental costs, competition for retail payphone service will be efficient. This principle was first established in another context, namely, the supply of interconnection or access as an essential wholesale service:

[T]he absolute level of the charge is irrelevant to the ability of the non-integrated rival to compete with the LEC. That ability depends, rather, on the relationship or margin between the interconnection charge—whether high or low, monopolistic or competitive—and the prices at which the LEC offers the competitive service.<sup>36</sup>

For the purposes of this case, the fact that both BellSouth Public and independent PSPs purchase the payphone access line service from the same tariff, coupled with TA 96's prohibition of subsidies to payphone operations, would ensure that retail payphone service competition will occur based on each carrier's relative efficiencies.

In general, shared and common cost recovery and profitability—while important regulatory concerns for determining just and reasonable rates—are irrelevant for determining whether an anti-competitive price squeeze exists.

**Q. WHAT ELSE SHOULD THE AUTHORITY NOTE ABOUT THIS ISSUE?**

A. I would urge the Authority to note two other salient points. First, the rates for the payphone access line services help or penalize BellSouth Public and its independent PSP competitors equally. If BST (or BellSouth Corporation) wanted to assist BellSouth Public by lowering the prices at which it purchases those services, the same lower prices would be automatically available to competing PSPs and no discrimination would be possible. That is why I believe that structural and non-structural safeguards in place protect against BST's payphone access line service rates being discriminatory.

Second, to some observers it may appear that the cost of those payphone services to BellSouth Public is just offsetting revenue to BST—both arms of the same parent corporation. In effect, therefore, a transaction would represent no real cost to BellSouth Corporation while, at the same time, any purchase by independent PSPs out of BST's tariffs

<sup>36</sup> Alfred E. Kahn and William E. Taylor, "The Pricing of Inputs Sold to Competitors: A Comment," *Yale Journal on Regulation*, 11, Winter 1994, at 225-240.

1 would be a real cost to those PSPs that have no automatic revenue offset. Based on this line  
2 of reasoning, those observers may conclude that structural safeguards like separate affiliates  
3 do not really protect competitors from anti-competitive price squeeze. This reasoning is  
4 wrong.

5 The flaw in this reasoning is that BST (and BellSouth Corporation) will receive the same  
6 payphone access line price, *irrespective* of which payphone provider (BellSouth Public or an  
7 independent PSP) actually carries the call. If its affiliate, BellSouth Public, were to carry the  
8 call, then BellSouth Corporation would not charge the payphone access line price to an  
9 unaffiliated PSP. Thus, a BellSouth Corporation manager attempting to optimize corporate  
10 profits would have to recognize that charge as a *cost* to BellSouth Corporation whenever  
11 BellSouth Public carried the payphone call—not because of imputation rules or separate  
12 affiliate accounting formulas, but because the payphone access line service charge that would  
13 have gone into BellSouth’s corporate pocket would no longer do so when its own affiliate  
14 carried the payphone call. Therefore, what may appear as a net revenue to BellSouth would  
15 turn out, under closer scrutiny, to really be a cost. Economists characterize such costs as  
16 opportunity costs. Failure to account for such costs can lead directly to the type of flawed  
17 reasoning described above.

18 **Q. DO YOU CONCLUDE THAT BST’S RATES FOR PTAS AND SMARTLINE®**  
19 **SERVICE SATISFY ALL REQUIREMENTS?**

20 A. Yes. The requirements are that payphone access line service rates be (i) cost-based, (ii)  
21 consistent with the requirements of Section 276 of TA 96, specifically with respect to the  
22 removal of subsidies to payphone service from basic exchange and exchange access  
23 services, (iii) non-discriminatory, and (iv) able to pass the new services test that applies to  
24 price cap LECs. I conclude that the rates are based on cost. BST has employed the proper  
25 cost standard for services, namely, TSLRIC, and demonstrated that the rate for each service  
26 at least recovers that cost (so that it cannot be anti-competitive). I conclude that there is no  
27 evidence of any subsidy flows from BST’s basic exchange or exchange access services to

1 the payphone access line rates.<sup>37</sup> I conclude that the tariffed rates are not discriminatory  
2 because the services in question are available to BST's payphone affiliate, BellSouth Public,  
3 and to competing independent PSPs on exactly the same charges, terms, and conditions.  
4 Moreover, I have explained why "high" rates for those services are not, on their face,  
5 unreasonable or likely to favor BellSouth Public over its competitors. Finally, I conclude  
6 that the rates pass the new services test within the parameters and guidelines provided  
7 (particularly with respect to acceptable degrees of overhead loadings or markups) by the  
8 FCC.

9 **Q. DO YOU CONCLUDE THAT BST'S RATES FOR PTAS AND SMARTLINE<sup>®</sup>**  
10 **SERVICE ARE FAIR AND REASONABLE?**

11 A. Yes. My analysis demonstrates that the rates for those services are not predatory or cross-  
12 subsidized, i.e., they are not anti-competitive. The loadings in those rates are also  
13 reasonable, particularly because of the parity between those rates and rates for business  
14 local exchange service. It should be kept in mind that PTAS and Smartline<sup>®</sup> are *business*  
15 services and, therefore, unlike residential local exchange service, not subject to the public  
16 policy that keeps rates low, even below cost. Moreover, being services, they are not subject  
17 to the TELRIC pricing methodology employed for interconnection or UNEs (as in Docket  
18 No. 97-01262).

19 **Q. DO YOU CONCLUDE THAT BST'S RATES FOR PTAS AND SMARTLINE<sup>®</sup>**  
20 **SERVICE CONFORM TO EFFICIENT PRICING PRINCIPLES?**

21 A. Yes. As I explained in my testimony, BST (like other LECs) has a cost structure that is  
22 typical of capital-intensive firms: large fixed and shared and common costs in comparison  
23 to low direct incremental costs for the services they provide. Those firms experience  
24 economies of scale and scope as a result. For that reason, it is vitally important that prices  
25 be set to recover not merely the incremental costs but the substantial other costs as well.

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<sup>37</sup> As BellSouth witness Thomas Lohman testified in this proceeding, BellSouth has identified the subsidy to payphone service from intrastate services and removed it by filing Tariff No. TN97-033. In fact, Mr. Lohman testified that the amount actually removed—\$789,000—exceeded the correctly calculated subsidy by \$171,000.

1 That, in turn, means the use of economically efficient markups in service prices. Because  
2 uniform loadings or markups are not economically efficient as long as the demand  
3 conditions differ across services, the Ramsey pricing rule (or some variant of it) should be  
4 employed to include market-determined markups in individual service prices. Because of  
5 the cost structure that BST has, overhead loadings or markups that are several multiples of  
6 direct incremental cost are not, on their face, unreasonable or inefficient.

7 **Q. DO YOU CONCLUDE THAT BST'S RATES FOR PTAS AND SMARTLINE®**  
8 **SERVICE PORTEND ILL FOR THE GROWTH OF THE PAYPHONE MARKET**  
9 **IN TENNESSEE?**

10 A. No. My analysis of Mr. Wood's claims shows that BST's payphone rates pose no imminent  
11 threat to the vitality of the payphone market in the state. In fact, historical subscribership  
12 trends show an increasing tendency (even among the lowest-income segment of the  
13 population) for households to subscribe to residential local exchange service. This does not  
14 automatically preclude payphone use, but it may signal a general drift toward more  
15 affordable privately-owned telephone service. My analysis reveals little to support the  
16 claim that PSPs are already losing a substantial amount of revenue on every payphone call  
17 that is currently made and that BST's rates will exacerbate that loss.

18 **Q. WHAT IS YOUR OVERALL CONCLUSION?**

19 A. My overall conclusion is that, contrary to Mr. Wood's testimony in this proceeding, BST's  
20 rates for payphone access line services, PTAS and Smartline®, have been constructed on the  
21 basis of sound economic principles and within FCC-provided guidelines and parameters.  
22 The Authority should not apply the TELRIC pricing methodology that was employed to  
23 determine rates for interconnection and UNEs in Docket No. 97-01262. BST's rates that  
24 are being examined in this proceeding are fair and reasonable and should give no cause for  
25 alarm about either the potential for further competition in Tennessee's payphone market or  
26 for the prospects of long-term survival of that market.

27 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

28 A. Yes.

**EXHIBIT WET-1**

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Dr. Taylor received a B.A. magna cum laude in Economics from Harvard College, an M.A. in Statistics and a Ph.D. in Economics from the University of California at Berkeley. He has taught economics, statistics, and econometrics at Cornell and the Massachusetts Institute of Technology and was a post doctoral Research Fellow at the Center for Operations Research and Econometrics at the University of Louvain, Belgium.

At NERA, Dr. Taylor is a Senior Vice President, heads the Cambridge office and is Director of the Telecommunications Practice. He has worked primarily in the field of telecommunications economics on problems of state and federal regulatory reform, competition policy, terms and conditions for competitive parity in local competition, quantitative analysis of state and federal price cap and incentive regulation proposals, and antitrust problems in telecommunications markets. He has testified on telecommunications economics before numerous state regulatory authorities, the Federal Communications Commission, the Canadian Radio-Television and Telecommunications Commission, federal and state congressional committees and courts. Recently, he was chosen by the Mexican Federal Telecommunications Commission and Telmex to arbitrate the renewal of the Telmex price cap plan in Mexico. Other recent work includes studies of the competitive effects of major mergers among telecommunications firms and analyses of vertical integration and interconnection of telecommunications networks. He has appeared as a telecommunications commentator on PBS Radio and on The News Hour with Jim Lehrer.

He has published extensively in the areas of telecommunications policy related to access and in theoretical and applied econometrics. His articles have appeared in numerous telecommunications industry publications as well as *Econometrica*, the *American Economic*

*Review*, the *International Economic Review*, the *Journal of Econometrics*, *Econometric Reviews*, the *Antitrust Law Journal*, *The Review of Industrial Organization*, and *The Encyclopedia of Statistical Sciences*. He has served as a referee for these journals (and others) and the National Science Foundation and has served as an Associate Editor of the *Journal of Econometrics*.

## EDUCATION

UNIVERSITY OF CALIFORNIA, BERKELEY  
Ph.D., Economics, 1974

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## EMPLOYMENT

NATIONAL ECONOMIC RESEARCH ASSOCIATES, INC. (NERA)  
1988- Senior Vice President, Office Head, Telecommunications Practice Director. Dr. Taylor has directed many studies applying economic and statistical reasoning to regulatory, antitrust and competitive issues in telecommunications markets. In the area of environmental regulation, he has studied statistical problems associated with measuring the level and rate of change of emissions.

BELL COMMUNICATIONS RESEARCH, INC. (Bellcore)  
1983-1988 Division Manager, Economic Analysis, formerly Central Services Organization, formerly American Telephone and Telegraph Company. While at Bellcore, Dr. Taylor performed theoretical and quantitative research focusing on problems raised by the implementation of access charges. His work included design and implementation of demand response forecasting for interstate access demand, quantification of potential bypass liability, design of optimal nonlinear price schedules for access charges and theoretical and quantitative analysis of price cap regulation of access charges.

BELL TELEPHONE LABORATORIES  
1975-1983 Member, Technical Staff, Economics Research Center. Performed basic research on theoretical and applied econometrics, focusing on small sample theory, panel data and simultaneous equations systems.

MASSACHUSETTS INSTITUTE OF TECHNOLOGY  
Fall 1977 Visiting Associate Professor, Department of Economics. Taught graduate courses in econometrics.

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Université Catholique de Louvain, Belgium.

1974-1975     Research Associate. Performed post-doctoral research on finite sample econometric theory and on cost function estimation.

#### CORNELL UNIVERSITY

1972-1975     Assistant Professor, Department of Economics. (On leave 1974-1975.) Taught graduate and undergraduate courses on econometrics, microeconomic theory and principles.

#### MISCELLANEOUS

1985-1995     Associate Editor, *Journal of Econometrics*, North-Holland Publishing Company.  
1990-           Board of Directors, National Economic Research Associates, Inc.  
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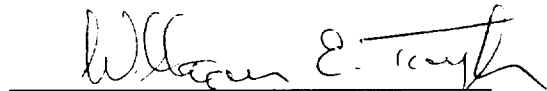
October, 2000

AFFIDAVIT

STATE OF: MASSACHUSETTS  
COUNTY OF: MIDDLESEX

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared William E. Taylor, Ph.D., Senior Vice President-National Economic Research Associates, Inc., who, being by me first duly sworn deposed and said that:

He is appearing as a witness before the Tennessee Regulatory Authority in Docket No. 97-00409 on behalf of BellSouth Telecommunications, Inc., and if present before the Authority and duly sworn, his testimony would be set forth in the annexed testimony consisting of 24 pages and 1 exhibit(s).



William E. Taylor

Sworn to and subscribed  
before me this 25<sup>th</sup>  
day of September, 2000

  
\_\_\_\_\_  
NOTARY PUBLIC